

EXECUTIVE SECRETARIAT

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1	DCI				
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16	NIO/ECON	X			
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Remarks

cc: Deane

Executive Secretary
23 Aug 85

Date

3637 (10-81)

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mtg
30 / Cases
27 Aug 85

**THE WHITE HOUSE
WASHINGTON**

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 8/23/85 **Number:** 316977CA **Due By:** _____

Subject: Economic Policy Council Meeting - Tuesday, August 27, 1985

2:00 P.M. - Roosevelt Room

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	CEA	<input type="checkbox"/>	<input type="checkbox"/>
Vice President	<input type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
State	<input type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input type="checkbox"/>
Commerce	<input type="checkbox"/>	<input type="checkbox"/>	Svahn	<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input type="checkbox"/>	<input type="checkbox"/>	Chew (For WH Staffing)	<input type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input type="checkbox"/>	Hicks	<input type="checkbox"/>	<input type="checkbox"/>
HUD	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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CIA	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
UN	<input type="checkbox"/>	<input type="checkbox"/>	DPC	<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input type="checkbox"/>	<input type="checkbox"/>	EPC	<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
EPA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
VA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be a meeting of the Economic Policy Council on Tuesday, August 27 at 2:00 P.M. in the Roosevelt Room.

The agenda and background paper are attached.

RETURN TO:

☐ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OEOB)

THE WHITE HOUSE
WASHINGTON

Executive Registry

85- 3115/4

August 22, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. MCALLISTER *EM*
SUBJECT: Agenda and Paper for the August 27 Meeting

The agenda and paper for the August 27 meeting of the Economic Policy Council are attached. The meeting is scheduled for 2:00 p.m. in the Roosevelt Room.

The single agenda item is a review of potential Section 301 investigations to be initiated by the President. A list and analyses of ten possible cases, prepared by the Office of the United States Trade Representative, is attached.

Attachments

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

August 27, 1985

Roosevelt Room

AGENDA

1. Potential Section 301 Investigations

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

August 22, 1985

M E M O R A N D U M

TO: Economic Policy Council
FROM: Ambassador Clayton Yeutter *CY*
SUBJECT: Section 301 Cases

Enclosed are summaries of 10 potential section 301 cases that have been developed on an interagency basis over the past couple of weeks. They are arranged in approximate priority order as we presently evaluate them at USTR though that is obviously subjective. The first two cases, in fact, are already in process, but are included here because they are ripe for acceleration by the U.S.

I will provide further background verbally on all of these when we meet next week. At that time we will wish to evaluate such factors as the flagrancy of the practice, the amount of trade involved, the longevity of the practice, the intensity and tenure of our complaints, our international competitiveness in the product involved, the strength of our case under our own law and international rules, our political and economic relationships with the country involved, etc. This may cause us to alter the priorities. We'll hone the list between now and then and when we meet I'll provide any necessary updates.

CY:bac

Enclosures

LIST OF POTENTIAL SECTION 301 CASES

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JAPAN - LEATHER AND LEATHER FOOTWEAR QUOTAS

TRADE PRACTICE

Japan maintains identical quota schemes severely restricting imports of leather and leather footwear. The U.S. has brought separate GATT actions against Japan on these issues.

In May 1984, the GATT Council adopted a panel report finding that Japan's leather import quotas are inconsistent with Article XI of the GATT. The GATT Council recommended that Japan eliminate the quotas. The illegal quotas, in combination with high tariffs, severely restrict U.S. leather exports to Japan. Since the adoption of the panel report, Japan has failed to take meaningful steps to improve the access to U.S. leather exports to Japan.

In June 1985, the United States asked the GATT Council to form a working party to consider three issues regarding the leather case: (1) how and when Japan intended to bring itself into conformity with the GATT panel's decision, (2) whether some form of compensatory adjustment is appropriate, and (3) whether the U.S. would be authorized to take compensatory measures. At the July GATT Council meeting, Japan announced that it would replace the illegal leather quota with higher tariffs pursuant to Article XXVIII of the GATT. These higher tariffs would serve to keep the Japanese market closed to U.S. exports and indeed could have an even more restrictive effect on U.S. exports. Japan therefore proposed to replace an illegal barrier to U.S. leather with a GATT-legal barrier. Japan further announced that it would enter into discussions with respect to Article XXVIII compensation after finalizing the tariff increase. Thus, while the U.S. might eventually receive compensation for the leather quota, this compensation must await further negotiations at some future point in time and with no assurance that the level of compensation would be adequate to redress the damage suffered by the U.S. industry. Meanwhile, the entry of U.S. leather exports continues to be severely restricted.

We initiated a Section 301 case against Japan on the footwear quota in December of 1982. We are about to initiate a GATT panel proceeding on the footwear quota under Article XXIII:2 and have argued that since the leather quota and leather footwear quotas are identical practices, the conclusions of the leather panel should apply to footwear. To date, Japan has taken no action to eliminate the footwear quota. We have held a series of bilateral consultations on the leather footwear quota under Articles XXII and XXIII in an effort to convince the Japanese to reduce or eliminate the quota on an MFN basis. Although the leather panel's decision was based solely on an examination of the leather quota, since the leather quota and leather footwear quotas are identical practices, we argued that in light of the leather decision the Japanese were obliged to eliminate both quota schemes. However, the Japanese have resisted this approach

and have insisted that we must go through a new Article XXIII:2 panel process on the leather footwear quota. We have agreed to the establishment of a panel and are in the process of negotiating terms of reference for the panel.

TRADE EFFECTS

The Japanese leather quota system has been found, both by the U.S. Government and by a GATT panel, to be in violation of Japan's international trade obligations. The tariff reduction on semi-finished leather imports made by Japan following the GATT panel's finding has been of very little benefit to the U.S. industry, since it affects only a miniscule portion of their exports to Japan. Indeed, it is of far greater benefit to the Japanese tanners who import semi-finished leather to manufacture finished leather which competes with U.S. exports. Additionally, the publication of the level of the quota, while useful information, has not aided U.S. leather exporters in increasing their sales. U.S. exporters remain substantially excluded from the Japanese market and this situation is not going to change in the foreseeable future. The situation will worsen if Japan follows through on its plan to raise its leather tariffs.

Although there has been no GATT panel finding with respect to the leather footwear quota, it is identical to the leather quota and it is clearly GATT inconsistent. The Japanese have taken no steps to liberalize or eliminate the footwear quota and it effectively excludes U.S. footwear exporters from the Japanese market.

EVALUATION OF THE PRACTICE

The quota system is a flagrant violation of Japan's obligations under GATT. In apparent recognition of this fact, Japan never attempted to defend the quota in GATT terms, but instead chose to argue that the quota was necessary to protect Japan's "Dowa" minority. Japan has chosen to respond to the GATT panel's finding by using the device of Article XXVIII to raise a tariff barrier against U.S. leather exports. Japan has not taken any steps to improve U.S. market access. The imposition of tariffs in this case will inhibit trade since any tariff increase will be on top of the already excessive 20 percent rate.

Congress is well aware of Japan's failure to take meaningful steps to improve U.S. market access. The Senate Finance Committee Report to the Danforth-Packwood Japan Retaliation bill (S. 1404) lists the leather quota as an example of Japanese unfair trading practices.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

Since a GATT panel has found that Japan's quota is illegal under GATT, there is no question that Japan has violated its international trade agreement obligations and that the President has the power to retaliate under section 301. The President can act immediately by retaliating unilaterally without GATT authorization.

Alternatively, the President could announce that he will seek authorization from the GATT Contracting Parties to implement retaliatory measures. To implement the retaliation, the President must act pursuant to his section 301 authority. There is a cleared Trade Policy Staff Committee (TPSC) position that the U.S. should go to the GATT Council (scheduled to meet in October) and seek authority to take counter-measures with respect to leather, pending removal of the quota and negotiation of a satisfactory compensation package. If the GATT Council fails to act within a reasonable period of time, the TPSC would recommend that the President retaliate unilaterally under section 301. With respect to footwear, however, it is unlikely that the Council would approve countermeasures at all since there has not yet been a panel finding in our favor.

With respect to the timing of retaliation, it seems clear that the U.S. has shown ample patience with the Japanese Government. The 301 case was initiated in 1977. We reached a settlement with the Japanese Government in 1979 in the expectation that market access would improve. After our expectations were not met, we followed the letter of the law by initiating and winning a GATT case.

While from a legal and procedural point of view there is reason to treat the leather and leather footwear cases separately in the GATT, they both involve the same practice which is a flagrant violation of the GATT. Therefore, if the President acts under section 301, he may want to retaliate both with respect to leather and leather footwear.

To implement this case, the President would request USTR to submit a retaliation proposal for his consideration. If he chooses not to wait for GATT authorization, he should nevertheless provide USTR 45 days to submit a proposal in order to allow adequate time for public comment.

EC - CANNED FRUITS AND RAISINS

TRADE PRACTICE

In 1978, the EC established a subsidy system to assist certain of its fruit processors. These subsidies were intended to allow higher-priced EC products to compete on an equal basis with imported items. Instead, the subsidies, combined in many instances with minimum import prices, have allowed EC products to be priced substantially below competing imports. Early efforts by the U.S. to restrain the growth of the subsidies and the number of products covered, were unsuccessful. The overall effect of the EC processing subsidy system has been to reduce or eliminate import competition. Clearly, this has occurred in canned fruits.

In October 1981, U.S. producers and processors of canned peaches, canned pears, fruit cocktail and raisins filed a Section 301 petition alleging that tariff concessions obtained from the EC on those products had been nullified and impaired by processing subsidies introduced by the EC. In July 1984, the GATT panel which considered this case found in favor of the U.S. on the canned fruits portion of the complaint, but determined that the EC subsidy scheme for raisins was essentially a continuation of an earlier Greek scheme. Although the GATT panel ruled in favor of the U.S. on canned fruits, our industry has thus far obtained no relief because attempts to negotiate a bilateral solution with the EC have been unsuccessful, and the EC has been unwilling to approve adoption of the panel report in the GATT Council. With continued EC intransigence, the only viable option for obtaining relief for U.S. fruit canners is unilateral U.S. action.

TRADE EFFECTS

The U.S. canned fruit industry is struggling to survive because of a number of factors, including the EC subsidies, the strong dollar, and competition from other countries such as Australia and South Africa. A substantial cut in EC processing subsidies would be necessary for U.S. canned fruit products to again be competitive in the European market. U.S. shipments of canned fruits to the EC market have dwindled to virtually zero over the past several years. The principle concern of the U.S. industry at this point is an EC invasion of the North American market.

EVALUATION OF THE PRACTICE

The EC processing subsidies for canned fruits have nullified or impaired concessions granted by the EC to the U.S. They have made U.S. product less competitive in the EC market and have contributed to a dramatic decrease in sales of U.S. fruit. In line with the GATT panel's recommendation, the EC should either reduce or eliminate its subsidies to restore competitive conditions or grant equivalent concessions to the U.S.

EC - CANNED FRUITS AND RAISINS

The EC subsidy system for fruit processors was intended to permit higher-priced EC products to compete on an equal basis with imported items. In practice, these subsidies--combined in many instances with minimum import prices--have allowed EC products to be priced substantially below competing imports. EC canned fruit subsidies, together with a strong dollar, have virtually eliminated U.S. product from the EC market.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorious claim that tariff concessions have been impaired. There is no need for further investigation; under U.S. laws the President can take action immediately to restrict EC imports into the U.S. as a means of re-balancing the level of trade concessions.

The President can implement the action by directing USTR to submit retaliation proposal for his consideration. To allow time for public comment on the proposed retaliation, USTR should be allowed 45 days to submit a proposal.

POSSIBLE EFFECTS OF 301 ACTION

There is clear domestic authority for action in this case. However, since the GATT has not adopted the panel report, the GATT has not authorized retaliation. In the citrus case, which is very similar, we decided to act under 301 without GATT authorization. However, that experience demonstrated the EC's willingness to counter-retaliate. Moreover, imposition of restrictive measures now could make it even more difficult to negotiate a final settlement of the citrus issue.

KOREA - INSURANCE

TRADE PRACTICE

Foreign firms are prohibited from writing life insurance for Korean nationals and compulsory fire insurance, which are the two most lucrative lines of insurance in Korea. American firms are eager to write these lines of insurance, and the American International Group (AIG) is prepared to file a 301 petition seeking access to both types of insurance.

AIG was given its original license in Korea immediately after the Korean war and was limited at that time to writing insurance for foreign nationals (primarily U.S. military). In the 1960's AIG sought an expanded license that would permit it to insure Korean nationals and their property. Finally, in March 1977, AIG felt that it had received a commitment from the Korean government to grant a marine insurance license within one year and to liberalize the officially sanctioned oligopoly of Korean fire insurance companies. When these commitments were not fulfilled, AIG filed a section 301 petition in 1979. USTR accepted the case and negotiated an agreement with the Government of Korea in December 1980, which required the government to issue a full marine insurance license by May 1981, to abolish the non-compulsory portion of the fire oligopoly by May 1984 and to establish an equitable retrocession arrangement during 1981. On the basis of this agreement, AIG withdrew its 301 complaint, but it made clear that its ultimate goal was to obtain access to the compulsory fire pool or to have it dismantled. Pursuant to this agreement, the Korean government granted AIG the full marine insurance license and revised the system of retrocessions. Non-compulsory fire insurance was liberalized on a de jure basis, but the government has not taken sufficient steps to prevent de facto exclusion of American firms from the oligopoly of domestic firms that controls noncompulsory fire insurance (the so-called banking pool).

During the past two years the USG has made innumerable representations to the Government of Korea: (1) to enforce its stated policy that non-compulsory fire insurance is open to foreign firms; (2) to grant American firms licenses to write compulsory fire insurance (which still is handled by an officially sanctioned oligopoly, the "fire pool") and compulsory automobile insurance; and (3) to grant American firms licenses to write life insurance for Korean nationals. During the U.S.-ROK Economic Consultations on July 1-2, the Koreans indicated that the Ministry of Finance had promised to make a proposal this year for a solution to the fire insurance problems but that implementation in any event would not begin until 1987. No commitment was made on life insurance, and we were informed that a liberalization of life insurance could be addressed only in the longer-term.

We informed the ROKG that the industry was ready to file another 301 petition unless the following two steps were taken: (1) the ROKG commits to phase-in full foreign participation in the fire pool at the rate of one city per month (there are seven cities covered by the pool), beginning in August; and (2) the ROKG agrees to provide the USG no later than January 1986 an acceptable plan for full foreign participation in the life insurance market. We have not had a response from the Korean government. AIG has revised its 301 petition to reflect the recent liberalization of auto insurance and will refile the petition if the Administration decides not to self-initiate it.

TRADE EFFECTS

Life insurance accounts for almost three-fourths of the total Korean insurance market; the value of premiums paid exceeds \$3.82 billion annually, and total life insurance in force is \$68.91 billion. We do not have an estimate for the value of premiums written by the Korean members of the fire pool, but the overwhelming proportion of significant buildings is reserved for those firms.

EVALUATION OF THE PRACTICE

The ROKG policy of denying American firms the right to issue compulsory fire insurance policies is a denial of national treatment and, therefore, appears to violate Article VII of the U.S.-ROK Treaty of Friendship, Commerce and Navigation (FCN). No Korean insurance company is prohibited from writing compulsory insurance, but all foreign companies are prohibited from writing compulsory insurance (except for the recently liberalized auto insurance). The Korean government also denies national treatment by not issuing licenses for American firms to write life insurance. Six Korean insurance companies are licensed to write life insurance, and no foreign firms have been granted such licenses. No new firms have been granted life insurance licenses since 1957.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorious claim that Korea is in violation of its FCN obligations by discriminating against U.S. insurers. Since this case involves services, the GATT is not involved. The investigation would include bilateral consultations/negotiations and would be completed in a maximum of one year (or earlier at our discretion). Our leverage to negotiate a solution lies in our willingness to restrict access for Korean goods and services in the U.S. market.

To implement this case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice of its investigation in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with the Korean Government.

BRAZIL - INFORMATICS

TRADE PRACTICE

In 1984, Brazil approved a complex new law codifying and extending past measures designed to promote a national informatics industry. The law provides broad authority to restrict imports for an eight year period and establishes a market reserve policy which sets aside for Brazilian-owned firms the exclusive right to produce and sell products within designated high-technology categories.

Brazil's informatics policy contains a wide array of restrictions limiting foreign involvement in the informatics sector. Most significantly, the market reserve policy retains for domestic firms the exclusive right to produce and sell designated product categories. The market reserve policy currently covers minicomputers, microcomputers, superminicomputers and robotics and can be extended to the entire digital processing industry.

National firms are given preference in government procurement and have access to special fiscal and financial incentives. These fiscal incentives include lower capital costs, tax incentives on capital goods and production inputs and exemptions from import duties and various national taxes. Local content and export performance requirements have been set up as conditions for establishing firms and receiving incentives. For example, a firm wishing to use foreign technology must locate production in a special export zone and produce exclusively for export. Non-national companies may also be eligible for these export incentives; however these exporters will be prohibited from selling their products domestically unless they satisfy the requirement that no "national similar" product is available. The Special Secretariat for Informatics (SEI) has the authority to intervene with foreign firm management to review and require changes in its mode of operation, approve manufacturing proposals, control the issuance of import licenses and issue regulations which restrict foreign company access to selected informatics market sectors.

A special intelligence report stated that SEI has closed Brazil's domestic market to imports of single board computer technology in an effort to promote the design and production of these products locally.

TRADE EFFECTS

The effect on U.S. firms of the informatics policy has been mixed. In general, however, the Brazilian restrictions have either totally excluded foreign firms from certain market segments or confined them to licensing their technology. Largely as a result of market reserve, U.S. multinationals operating in Brazil repeatedly have been denied approval of manufacturing proposals for new product lines. In addition, all companies in Brazil

have found it increasingly difficult to import needed inputs. SEI's strict review of import license applications--to ensure that there is no import competition for locally-manufactured goods--has forced companies to maintain inventories of parts and components substantially beyond that which would normally be required under free market conditions.

Brazilian imports of computer products fell 17 percent to \$139 million in 1983 from a five year high of \$166 million in 1982. Parts represented 36 percent of the 1983 total, the highest percentage during the 1978-83 period. The United States was by far the the largest supplier of computer products to the Brazilian market, accounting for \$88 million or 63 percent of the 1983 import total. However, computer parts accounted for a larger share of the total, up to 41 percent in 1983, from a low of 29 percent in 1980. The value of equipment imports from the United States fell to \$52 million, roughly equal to the 1980 level; this drop reflects the effect of Brazilian market restrictions. Although 1984 figures are not available from Brazil, U.S. export figures show that during the first 9 months of 1984, U.S. computer equipment exports fell 10 percent to \$34 million. Parts exports increased 96 percent to \$106 million and accounted for 76 percent of total U.S. computer parts and equipment exports to Brazil, the highest thus far.

EVALUATION OF THE PRACTICE

An examination of trends in U.S. exports to Brazil shows that the informatics policy has had a dampening effect on U.S. informatics industries. A comparison of the growth in U.S. trade with Brazil in computer products with the growth of the Brazilian computer market indicates that U.S. firms did not fully participate in the expansion of Brazil's computer market in recent years. During the 1980-82 period when the Brazilian market expanded rapidly, due primarily to the microcomputer segment, U.S. exports grew at only 14 percent annually while the Brazilian market increased by 30 percent.

Texas Instruments, Hewlett Packard, IBM, Burroughs, Digital Equipment Corporation and Ford/Philco have all experienced lost immediate sales and reduced long-term commercial prospects. As a result of Brazil's informatics policy, U.S. firms have been forced to maintain restricted operations in Brazil; sold or closed all or part of their Brazilian operations; and transferred technology to a Brazilian firm.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorious claim that Brazil's market reserve is in violation of its GATT obligations. Even if Brazil were to successfully claim an infant industry or national security defense, the U.S. could request compensation or be authorized to retaliate. Although we have had one round of GATT consultations with Brazil on its informatics policy, we would not expect to complete GATT action in less than two years.

Preferences for Brazilian firms with respect to government procurement are permitted under the GATT. Accordingly, this aspect of the Brazilian informatics policy could not be pursued in GATT. Also, it is unlikely that Brazilian domestic subsidies for computer manufacturers would be pursued successfully in the Subsidies Code, since (1) the Code's disciplines over domestic subsidies are relatively weak and (2) Article 14:7 provides a further dispensation for developing countries. We therefore might wish to limit the 301 case at this point to the market reserve issue.

The President can implement this decision by directing USTR to self-initiate a 301 investigation. USTR would then publish notice of that fact in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with Brazil. Since we have already had consultations with Brazil under Article XXII of the GATT, we might wish to move directly to consultations under Article XXIII. This would then lay the foundation for moving directly to a GATT panel if the consultations do not lead to a resolution of the dispute.

POSSIBLE EFFECTS OF 301 ACTION

Since U.S. firms are currently operating in Brazil and could be subjected to harassment as "punishment" for the initiation of the 301 investigation, we should contact industry representatives before deciding whether to initiate to be certain we have their support.

JAPAN - TOBACCO

TRADE PRACTICE

U.S. exporters of cigarettes to Japan face three barriers:

1. a high import duty and tax-on-duty;
2. the continued monopolization of manufacturing; and
3. government restrictions on product distribution.

The principal barrier to market access remains the 18.8 percent import duty. When multiplied by the largely ad valorem domestic excise tax, the duty reaches an effective level of 37.5 percent, double the original duty. This high duty continues to be a significant impediment to American cigarette sales in Japan.

The second major barrier is the Government of Japan's monopolization of cigarette manufacturing. Because U.S. manufacturers are prohibited from establishing production facilities in Japan, there is no way to circumvent the duty or its inevitable effect on retail prices. This lack of access to local production by U.S. companies results in de facto discriminatory treatment against American cigarettes.

Restrictions on product distribution constitute a third major barrier. Although the distribution of tobacco products has technically been liberalized, the only practical means of distribution continues to be through the Tobacco Haiso, which is owned and controlled by the Japan Tobacco Inc. (JTI). The non-availability of other feasible distribution options severely limits the access that U.S. companies have to the Japanese market.

TRADE EFFECTS

The Japanese market for tobacco is estimated at \$10 billion annually. Despite intense bilateral discussion over the past four years, and the expenditure of \$100 million in marketing and sales efforts by U.S. manufacturers, the U.S. share of Japan's cigarette market has grown only from 1.4 percent in 1981 to 2.1 percent in mid-1985. Any objective evaluation would conclude that this is an unacceptably small market share, given U.S. competitiveness in cigarettes.

EVALUATION OF THE PRACTICE

In light of the severe and economically unjustifiable restrictions placed on American cigarette sales in Japan, it is unlikely that the situation will improve in the near future. Absent aggressive action on the part of Japan to reverse these practices, this issue will re-emerge as a major bilateral irritant.

JAPAN - TOBACCO

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The Japanese tariffs, while high, are not a violation of GATT. Furthermore, the excise tax is non-discriminatory and therefore not GATT-illegal. The manufacturing restriction is blatant; however it is not covered by GATT. Because the tobacco practices are not actionable under GATT, this case would probably be best pursued on a bilateral basis outside of GATT. In that event an investigation would be completed within one year. Our leverage to negotiate a solution would be our willingness to retaliate by restricting access for Japanese goods or services to the U.S. market.

To implement such a case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice to that effect in the Federal Register, solicit public comment and request consultations with Japan.

U.K. RESTRICTIONS ON FIRMS SERVICING NORTH SEA OIL FIELDS

TRADE PRACTICES

For ten years the United Kingdom has followed a policy of restricting the ability of foreign engineering and construction companies to provide engineering services and goods to offshore oil fields. This is done by conditioning the grant of leases to develop offshore oil fields to agreement to procure such goods and services from U.K. firms.

Until 1985, any firm chartered in the U.K. was considered a U.K. firm for purposes of this policy. However, in January of this year the U.K. government made this policy even more restrictive by requiring that procurement be made from firms with a majority British ownership.

TRADE EFFECTS

It is difficult to quantify the trade effects of the U.K. practice. Until January, U.S. companies could continue to do business by locating their firms in the U.K. Moreover, the impact of the new restriction may be lessened by U.S. companies forming joint ventures with U.K. partners. Nevertheless, the U.K. is the second most profitable market for U.S. oil industry engineering and contracting firms, after the U.S. market. (While joint ventures may allow U.S. firms to remain in the U.K. market, they will also reduce total profits of the U.S. firms).

EVALUATION

U.S. firms have complained to the U.S. government about the U.K. practice, but more recently have asked that the U.S. not intervene. U.S. firms appear to be ready to comply with the new British regulations by entering into joint ventures with British partners.

The U.K. government has reacted strongly to USG complaints. U.K. officials have pointed to the U.S. Jones Act as a similar discriminatory practice. The U.K. government has also used U.S. extraterritoriality policy as an excuse for cutting back reliance on U.S.-owned firms.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.K. is clearly restricting the ease with which U.S. companies can offer their services in the U.K. market; however, it is not violating any international obligations in doing so. Thus the U.S. case would be based on the premise that the U.K. policy, while not illegal, is unreasonable. We therefore face the problem of articulating a standard of reasonable behavior against which to measure the U.K.'s practice. Generally, we look to the practices of other countries, including the U.S. However, since

the U.S. also restricts foreign service suppliers under the Jones Act, it becomes more difficult to label the U.K. practices as unreasonable. Moreover, if U.S. firms can continue to service North Sea oil fields through the establishment of joint ventures, it may be difficult to demonstrate the requisite burden on U.S. commerce.

Since this case does not involve the GATT, an investigation would be completed within one year. Our leverage to negotiate an end to the restrictions in the U.K. market would depend on our willingness to restrict access for U.K. goods or services into the U.S. market.

To initiate this action, the President would direct USTR to self-initiate an investigation under Sec. 301. USTR would publish a notice to that effect in the Federal Register, solicit public comment on the issues to be investigated, and request consultations with the U.K.

POSSIBLE EFFECTS OF 301 CASE

A 301 investigation could backfire if the U.S. firms it is designed to assist were to oppose our action. As noted above, U.S. firms seem willing to enter into joint ventures to circumvent the U.K. policy. They might view a 301 investigation as jeopardizing this accommodation. This suggests that we should seek industry views before making any decisions on this case.

FEDERAL REPUBLIC OF GERMANY - TRANSBORDER DATA FLOWS

TRADE PRACTICE

Telecommunications services in the Federal Republic of Germany (FRG) are controlled by the Deutsche Bundespost. The Bundespost's method of assessing charges for international leased lines is a problem for certain U.S. companies who want to send large volumes of data out of the country. These companies want to be able to lease a telephone line from the Bundespost at a "flat rate" (i.e. non-volume sensitive). However, the Bundespost will only provide an international leased line at a flat rate if the company assures the Bundespost that they are sending processed data out of Germany. If the company wants to send unprocessed data out of Germany, then they will be charged on a volume basis. The disparity between flat and volume-sensitive rates forces companies to process data in Germany.

The processing requirement applies to all companies operating in Germany, except for 15 companies who had existing flat rate international leased lines when the volume charging was introduced. These companies will be able to maintain their flat rates for unprocessed data on existing applications through 1987. For all other new applications, either by the 15 exempted companies or other companies, volume charging will be required.

A company leasing a flat rate line must assure the Bundespost of their ongoing compliance with the processing requirement. If the company does not comply, a fine is assessed and the leased line may be cut off. If the Bundespost is suspicious that the data is not processed locally, then they will install a meter and impose volume charging. If a company cannot convince the Bundespost that it is processing domestically, the leased line will be available only if the subscriber performs traffic measurement. The Bundespost may apply additional charges in addition to the volume-sensitive tariffs.

TRADE EFFECTS

U.S. industry reports a number of firms have relocated their data processing centers outside of the FRG to avoid Bundespost regulations on volume-sensitive tariffs and requirements to process data locally.

EVALUATION OF THE PRACTICE

The FRG practice imposes additional costs on those firms which must send data out of the FRG. Either they must pay for processing their data or pay the volume sensitive charges for their leased lines. If companies do not process their data locally, the Bundespost's volume charges take away any benefit the companies might have gained under a flat rate for using their lines to their maximum efficiency. The Bundespost practice is anti-

competitive and is intended to increase its revenues. The processing aspect acts as a domestic content requirement. While this practice does not violate the GATT, it clearly has the effect of restricting the free flow of data across FRG borders. This is a clear example of the type of practice we are trying to change in the course of our negotiating efforts in the services sector.

There is no published definition of "processing" as used by the Bundespost. Companies must submit all proposed applications to the Bundespost for its approval. The Bundespost states generally that processing means working on data to create new information out of the data received. It must be more than the simple collection and/or sorting of data. For example, a conversion of codes, speed format, or protocol, the addition of the time and or the date is not considered to be processing.

The Bundespost claims that the data processing requirement is necessary to prevent subscribers within the FRG from using others' leased lines to transmit data outside of the FRG, thereby bypassing the subscriber-dialed public switched networks. The Bundespost claims that the processing requirement is the only means available to prevent such by-passing. Further, the Bundespost argues these measures are designed to preserve its revenues to allow it to provide full, identical services throughout the FRG, even in areas where traffic does not generate sufficient revenue to cover costs, as required by FRG law and policy. In effect, this permits the Bundespost to maintain the equivalent revenue from international leased lines as it would receive if the same firms used the Bundespost public switched network. Even though the objective of the Bundespost regulations does not explicitly require in-country processing, they do have that effect. U.S. providers of data processing services complain that these ordinances place much greater restrictions on the use of the network than comparable U.S. regulations.

This issue is a long-standing one with the FRG. In 1982, USTR expressed its concerns through a series of letters between Ambassador Brock and FRG Economics Minister Lambsdorff. The issue has been raised on numerous occasions since then.

Progress has been slow for several reasons. (1) The FRG is not violating any international agreements. They argue that this is a domestic issue which relates to the Bundespost's legal mandate to provide and regulate high-quality telecommunications networks for all consumers throughout the FRG. (2) Although certain U.S. companies have complained that compliance with Bundespost regulations is costly, we have no information that U.S. companies are being discriminated against. (3) The Bundespost has been adamant in opposing any U.S. challenges to their practices.

The U.S. objective is to obtain the availability of flat rate tariffs (which are cost-based) for international private leased lines and remove any impediments to the free flow of information across FRG borders.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

Trade in services is not yet covered by the GATT. We could deal with the case outside of GATT, arguing that the FRG acts unreasonably in restricting the free flow of information across its borders. Our theory would be that it is unreasonable for the FRG to maintain a pricing policy for transborder data flow that has the effect of charging a higher price for unprocessed data and therefore forcing U.S. companies to process data in the FRG.

The investigation would include bilateral negotiations and would be completed within one year.

To implement this case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice of this fact in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with the FRG.

POSSIBLE EFFECTS OF 301 ACTION

Our leverage to negotiate a solution with the FRG depends on our willingness to retaliate by restricting access to the U.S. market for FRG goods and services. Retaliation in goods would likely put the U.S. in violation of its GATT obligations.

We should assume that the FRG might take action against us either unilaterally or through the GATT if we restrict FRG imports into the U.S. We should also be concerned that a confrontational approach would lead to further restrictions on U.S. firms. Therefore, we would want to consult with the affected U.S. businesses before deciding to take action. It could also make it more difficult for the FRG Economics Ministry to continue pressuring the Bundespost to liberalize.

JAPAN - ALUMINUM CARTEL

TRADE PRACTICE

Pursuant to a special law for the structural improvement of industries, Japan has designated the aluminum fabricating industry as requiring structural adjustment. While the GOJ does not concede that it has created a cartel, the industry is authorized, subject to specific MITI and Japan Fair Trade Commission (JFTC) approval, to reduce capacity and control investment.

Under the plan for the aluminum industry (which has been approved by MITI and JFTC and is in effect through 1988), the companies agree with MITI on demand and supply forecasts, joint research is permitted, mergers are officially encouraged, and joint buying and selling may be permitted (it is not known whether this latter activity is occurring now). The industry also benefits from the fact that aluminum ingots imported by Japanese smelters (many of whom are related to the aluminum fabricators) are granted duty free treatment. Such duty-free treatment is not granted to other importers.

TRADE EFFECTS

U.S. exporters currently have less than 1% share of Japan's fabricated product market. Japanese aluminum exports to the U.S. have increased significantly during the 1973-83 period.

EVALUATION OF THE PRACTICE

Japan's practices are not covered by the GATT and do not violate any international laws. Thus, a 301 case would have to be based on the premise that Japan's practices are unreasonable and a burden on U.S. commerce. We therefore face the problem of articulating a standard of reasonable behavior against which to measure Japan's practice. Section 301 provides no guidance on this point. Generally, we would look to the practice of other countries, including the U.S. With respect to burden on U.S. commerce, we lack sufficient information both as to burden and its causal link to the Japanese practices to comment on the substantive merits of the case. We know that Japanese imports of ingots have increased substantially, but do not know whether this is due to some collusive behavior. We also cannot quantify the relative burden that would remain from tariff protection if the cartel activity ceased.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

As noted above we need to develop further information before we can evaluate the merits of this case. If we did initiate an investigation, it would be handled on a bilateral basis and would be completed within one year. Our leverage to negotiate a resolution would lie in our willingness to retaliate. To implement this case, the President would direct USTR to self-initiate an investigation. USTR would publish a notice to that effect in the Federal Register, solicit public comment, and request consultations.

TAIWAN - LACK OF PATENT PROTECTION FOR CHEMICAL COMPOUNDS, INCLUDING PHARMACEUTICALS

TRADE PRACTICE

Article 4 of Taiwan's patent law expressly excludes "chemicals" from patentable subject matter. The Ministry of Economic Affairs, in 1976, issued an interpretative directive that included chemical compositions and new methods of use for chemicals in the definition of "chemicals". The latter directive was modified in 1981 to permit patenting of compositions of two or more active ingredients which produce a synergistic effect, but that does not extend to most agricultural chemicals and pharmaceuticals which involve only one active ingredient. Only new processes for manufacturing chemicals and multiple active ingredient chemical compositions, therefore, are patentable in Taiwan.

TRADE EFFECT

Patents give an inventor the right, for a limited time, to prevent others from making, using, or selling his patented product or from using his patented process. Without patent protection for an invention which is a product, others are free to copy the product and compete directly with the inventor in the market place. Since copying generally would have little or no associated research and development costs, the copier has a competitive advantage over the inventor in marketing its product.

There generally are numerous chemical processes for producing a particular chemical so patenting a process of manufacture does not ensure the inventor of a new chemical that he will be able to exploit his invention without competition during the term of the process patent. Since Taiwan patent law practice requires very narrow claims, particularly regarding the temperature and pressure at which the process takes place, it enables local producers to "invent around" a process relatively easily. Also, in Taiwan as in the United States, infringement of a process patent exists only when the process is practiced within the borders of the country. Importation of a product does not constitute infringement.

For these reasons, U.S. agricultural chemical and pharmaceutical manufacturers frequently face competition from local producers that have copied their products merely by using different processes of manufacture. Local firms also frequently import the products from producers in countries, like Korea, where patent protection for chemical compounds is equally weak. Some Taiwan firms now export their products to third countries in the Middle East and Far East where patent protection is weak or non-existent. Local firms generally are able to price their products below those of the U.S. inventor because they have no associated research and development costs and, in some cases, can even have their products approved for marketing on the basis of pharmaco-

logical and toxicological data submitted by the U.S. firm in its application for approval to market.

EVALUATION OF THE PRACTICE

Taiwan's patent law is similar to the patent laws of most developing countries in that it does not provide protection for chemical compounds, single active ingredient compositions, and methods of use. Beginning in March of 1983, the American Institute in Taiwan with advisers from USTR, the State and Commerce Departments, including the Patent and Trademark Office has consulted with Taiwan authorities regarding intellectual property trade problems generally. In May of 1985, the Taiwan authorities told representatives of USTR and PTO that they had decided to amend their patent law to make chemical compounds and new methods of using chemicals patentable. On August 13, the Taiwan authorities reported to representatives of USTR and PTO that the first draft of the patent law amendment had been completed. The Taiwan authorities agreed that they would provide a copy of the draft to the U.S. side and would consult with the U.S. before the final version is introduced to the Legislative Yuan. Consultations are expected in October.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The Paris Convention for the Protection of Industrial Property does not specify categories of invention that must be protected by a country's patent law. It requires only that nationals of countries signatory to the Convention receive the same treatment as domestic parties under the law, called "assimilation." There is, therefore, no international agreement that could serve as a basis for a section 301 action. The President would have to determine, and publish a notice stating, that some act, policy or practice of the Taiwan authorities was "unreasonable" before any retaliatory step could be taken. To date, the President has not found that the mere failure to act in a particular situation is "unreasonable." An investigation would have to be completed within one year.

To initiate an investigation, the President would direct USTR to self-initiate an investigation. USTR then would publish a notice in the Federal Register indicating the nature of the investigation and asking for public comments. Consultations would be requested with the Taiwan authorities.

POSSIBLE EFFECTS OF 301 ACTION

As explained above, the Taiwan authorities have stated that they intend to amend their patent law to provide protection for chemical compounds, methods of use, and single active ingredient compounds. They have agreed to provide a copy of the draft amendment and to consult with U.S. experts before introducing the

bill into the Legislative Yuan. When the authorities consulted with U.S. experts regarding the then draft copyright law in April of 1984, they followed through by redrafting the proposal to take into account some of the U.S. concerns and introduced the bill in the Legislative Yuan, where it was enacted in June of 1985. There has been no indication of duplicity in the patent area that would lead us to believe the same process will not be followed in this case.

To date, Taiwan has made significant improvements in the protection it affords intellectual property. It has amended its trademark law to increase penalties and ensure that unregistered foreign corporations have access to the courts to enforce their rights. It has amended its copyright law extending the term of protection, expressly including protection for computer software, increasing penalties, and assuring access to the courts to unregistered foreign corporations. A draft unfair competition law will be introduced in the Legislative Yuan next month. U.S. experts will consult with the Taiwan authorities in October regarding implementation of the copyright law and regarding the draft patent law amendment.

Initiation of a section 301 investigation at this time could jeopardize the achievements that have been realized to date through ongoing consultations with the Taiwan authorities. The authorities could take the view that they will delay further movement on implementation of the copyright law, enactment of the unfair competition law and amendment of the patent law until they can determine the exact minimums acceptable to the U.S. side in each of these areas. We could lose valuable time and the resulting changes in the law might be less than will be achieved through ongoing consultations. Finally, changes forced upon the authorities could be implemented less thoroughly than would changes resulting from persuasion.

Other countries with which the U.S. has been holding consultations also might delay changes in the intellectual property area until we bring similar trade actions against them, since it would appear that voluntary changes made after consultations with the U.S. will not prevent such trade actions.

EC - EXPORT SUBSIDY ON WHEAT AND BARLEY TO THE SOVIET UNION

TRADE PRACTICES

The EC subsidizes exports of wheat and barley to the U.S.S.R. The EC share of the Soviet grain market has risen from an average of 1.8 percent in the 1974-79 marketing years to 16 percent in 1984/85. This occurred in an increasing Soviet market.

TRADE EFFECTS

W kept at certain level

The U.S. market share for all grains in the Soviet Union has declined from 62.2 percent during the 1974-79 marketing years to an estimated 41 percent for the 1984/85 year. USDA estimates that the subsidized EC sales have displaced U.S. wheat and corn exports valued at \$350 million annually.

EVALUATION OF THE TRADE PRACTICE

There is no question that the EC subsidizes its grain exports and that its share of the U.S.S.R. market has grown. However, the GATT only prohibits export subsidies on agricultural commodities if the subsidy results in the exporting country receiving more than equitable share of the world market or if it displaces other suppliers to the market. These rules are very imprecise; we have not been able to obtain satisfactory results in the GATT on other agricultural subsidy issues. On that basis alone it is uncertain whether we would win this case in the GATT.

Moreover, the EC may be able to make at least two strong counter arguments to the U.S. complaint. First, the EC may argue that its subsidies are not the cause of our lost market share. They can argue that the U.S. sales restrictions to the Soviets imposed in 1980 (sales were limited to 8 million tons -- in effect cancelling contracts for 13.5 million tons) negated previous market share achievements by the United States. Therefore, it may not be appropriate to use the 1974-1979 period as a basis for computing the U.S. share. The EC will also note that when the U.S. lost market share due to the 1980 sales restrictions, it was picked up principally by Canada and Argentina.

Second, the EC will argue that the U.S. is now increasing its share of the U.S.S.R. market. While the EC market share has been growing (especially in the last three years), it appears to be at the expense of the U.S. only in 1982/83 and then at the expense of Canada and Argentina in 1983/84 and 1984/85. In the latter two years the U.S. share actually increased. This coincided with the signing of a new LTA in August, 1983.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has less than a 50-50 chance of winning this case in the GATT. The GATT rules on agricultural subsidies are weak and the issue is complicated by the fact that the U.S. embargo of grain sales to the U.S.S.R, and the subsequent LTA have had a significant impact on U.S. trade. An investigation of this issue would involve a GATT dispute settlement case which would likely take up to two years to complete. However, because this is a subsidy issue, USTR would be required to make a recommendation no later than 7 months after the date of initiation of the investigation. At that point, the President would have to decide whether to act without GATT authority or to direct USTR to continue dispute settlement.

To implement this case the President would direct USTR to self-initiate an investigation. USTR would publish notice to that effect in the Federal Register, solicit public comment on the issue, and request consultations with the EC. If consultations are not successful in resolving the issue, we would initiate a dispute settlement panel.